87-1775

NO.

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1987

AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA,

Petitioner,

v.

ATLANTIC PERMANENT FEDERAL SAVINGS & LOAN ASSOCIATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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QUESTION PRESENTED

Whether applicable Federal Home Loan Bank Board regulations concerning indemnification by federal savings and loan associations of their directors and officers preempt the application of state law subrogation principles to allow recovery under a directors' and officers' liability insurance policy for unlawfully indemnified expenses.

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IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1987

No. _____

AMERICAN CASUALTY COMPANY
OF READING, PENNSYLVANIA,
Petitioner,

v.

ATLANTIC PERMANENT FEDERAL
SAVINGS & LOAN ASSOCIATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

American Casualty Company of Reading, Pennsylvania[1] petitions for a writ of

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[1] Pursuant to Rule 28.1 petitioner states that it is a wholly-owned subsidiary of Continental Casualty Company. National Fire Insurance Company of Hartford, Transportation Insurance Company, Transcontinental Insurance Company and Valley Forge Insurance Company are also owned (in whole or in part) by Continental Casualty Company. Continental
(Footnote Continued)

certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a) is reported at 839 F.2d 212. The opinions of the district court (Pet. App. 38a and 55a) are unreported.

JURISDICTION

The opinion of the court of appeals affirming the district court's judgment was entered on February 12, 1988. A timely petition for rehearing was denied on March 29, 1988. The jurisdiction of this court is involved under 28 U.S.C. § 1254(1).

(Footnote Continued)
Casualty Company is owned by CNA Financial Corporation.

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

Article VI, clause 2 of the United States Constitution provides:

> This Constitution, and the Laws of the United States that shall be made in Pursuance thereof; and The Treaties made or which shall be made under the Authority of the United States, shall be the Supreme Law of the Land; and the Judges in every State shall be bound thereby; any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

The preemption provision of 12 C.F.R. § 545.2 provides:

> The regulations in this Part 545 are promulgated pursuant to the plenary and exclusive authority of the Board to regulate all aspects of the operations of Federal associations, as set forth in section 5(a) of the Home Owners' Loan Act of 1933. 12 U.S.C. 1464, as amended. This exercise of the Board's authority is preemptive of any state law purporting to address the subject of the operations of a federal association.

12 C.F.R. § 545.121 is set forth at Pet. App. 97a.

STATEMENT OF THE CASE

This directors' and officers' liability insurance coverage dispute was tried in federal district court, pursuant to diversity jurisdiction. Petitioner issued the policy to respondent, a federally chartered savings and loan association. The policy covered losses relating to certain acts of the respondent's directors and officers. The policy did not cover losses relating to acts of respondent itself or respondent's subsidiaries.

Respondent alleged in its Complaint that it was entitled to recover "in its own right and as subrogee to the rights" of its former directors and officers approximately $1,444,000 in expenses incurred in defending and settling an action brought by home improvement loan borrowers against respondent, one of

respondent's subsidiaries and three of respondent's directors and officers.[2]

Insuring agreement (a) of the policy covers the directors and officers directly for covered losses that they incur. Insuring agreement (b) provides coverage for the respondent to the extent that it is required to indemnify or "has, to the extent permitted by law," indemnified its directors and officers for covered losses.

Petitioner moved for summary judgment on respondent's claim because respondent's indemnification of the directors and officers violated the controlling federal regulations. The district court, while

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[2] In the underlying action the borrowers alleged that the defendants knowingly, unlawfully and willfully conspired to defraud the plaintiffs by acting improperly with respect to loan applications, the release of construction funds and the foreclosure of the plaintiffs' properties.

not deciding whether the indemnification was unlawful, ruled that respondent could pursue its claim as subrogee of the directors and officers. (Pet. App. 48a-49a).

The jury awarded respondent approximately $948,000 in compensatory damages, having decided that the rest of the claimed expenses were either unreasonable or properly allocable to respondent and/or its subsidiaries and therefore not covered by the policy.

Petitioner moved for judgment notwithstanding the verdict on the grounds that the district court erred in ruling that respondent was subrogated to the rights of the directors and officers.[3]

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[3] Petitioner raised several other issues in its motion for judgment notwithstanding the verdict and on appeal (Footnote Continued)

The district court denied this portion of the motion without comment. (Pet. App. 87a).

Petitioner appealed from the judgment. On appeal, petitioner pointed out that because respondent's indemnification of its directors and officers was unlawful, insuring agreement (b) was inapplicable. Petitioner again argued that the doctrine of subrogation should not be applied to circumvent the intent of the insuring agreements and the Bank Board regulations.

On February 12, 1988, a panel of the court of appeals affirmed the judgment.

(Footnote Continued)
to the court of appeals. Most of these issues are addressed in the district court's March 12, 1987, opinion (Pet. App. 55a) and the court of appeals' decision. (Pet. App. 1a). Since certiorari is not sought with respect to these issues, they are not discussed herein.

The court agreed that respondent was not entitled to proceed under insuring agreement (b) because the indemnification procedure violated the applicable federal regulations. (Pet. App. 14a, fn. 5). However, the court ruled that respondent could proceed as subrogee of the rights of its directors and officers. The court explained that if insuring agreement (b) was intended to preempt subrogation rights, the policy should have said so expressly. (Pet. App. 17a).

Petitioner filed a timely petition for rehearing. The panel denied the petition on March 29, 1988. (Pet. App. 93a).

REASONS FOR GRANTING THE WRIT

1. Introduction: The Court of Appeals' Error

The court of appeals ruled that, in indemnifying its directors and officers, respondent failed to comply with the

applicable Federal Home Loan Bank Board's regulations. (Pet. App. 14a, fn. 5). Accordingly, the court ruled that respondent could make no claim under insuring agreement (b) (the indemnification coverage of the policy). Nevertheless, the court sanctioned respondent's reliance on the common law principle of subrogation to circumvent the Federal Home Loan Bank Board's express regulatory requirements regarding indemnification of directors and officers.

The Bank Board's regulations contain an unequivocal preemption provision that prohibits such an abrogation of its requirements by state law. This Court has consistently given preemptive effect to such preemption provisions as mandated by the Supremacy Clause, Art. VI, cl. 2, of the Constitution. This Court should review the court of appeals' decision in

this case to preserve the integrity of the federal preemption principle and the regulatory scheme of the Bank Board.

2. **The Federal Preemption Principle**

The Supremacy Clause, Art. VI, cl.2 of the Constitution provides:

> This Constitution, and the Laws of the United States that shall be made in Pursuance thereof; and The Treaties made or which shall be made under the Authority of the United States, shall be the Supreme Law of the Land; and the Judges in every State shall be bound thereby; any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Pursuant to the Supremacy Clause, enactments of Congress or federal agencies displace, or preempt, inconsistent state law. Preemption occurs when state law actually conflicts with federal law, making compliance with both impossible. Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 reh'g denied, 374 U.S. 858 (1963). Preemption may be by

implication or, as here, by express preemption provision. See Jones v. Rath Packing Co., 430 U.S. 519, 530-31 reh'g denied, 431 U.S. 925 (1977).

It is well-established that "[f]ederal regulations have no less preemptive effect than federal statutes." Fidelity Federal S. & L. Ass'n v. de la Cuesta, 458 U.S. 141, 153-54 (1982).

Whether the state law in question is a statute, or, as here, a facet of the state's common law makes no difference; each may be preempted. The examples of federal preemption of state common law are numerous. Ridgway v. Ridgway, 454 U.S. 46 (1981) (state divorce decree preempted by Federal military insurance law); San Diego Bldg Trades Counsel v. Garmon, 359 U.S. 236, 247 (1959) (obligation to pay damage award is potent method of governing conduct and controlling policy); Silkwood

v. Kerr-McGee Corp., 464 U.S. 238, 256, reh'g denied, 465 U.S. 1074 (1984), and on remand, 769 F.2d 1451 (10th Cir. 1985), cert. denied, 476 U.S. 1104 (1986) (imposition of state standard in damage action would frustrate objectives of federal law).

Recently several federal circuit courts of appeal have considered the tension between federal regulations and state common law. See Palmer v. Liggett Group, Inc., 825 F.2d 620, 627-28 (1st Cir. 1987) (Federal Cigarette Labeling and Advertising Act preempted state tort law); Stephen v. American Brands, Inc., 825 F.2d 312 (11th Cir. 1987) (same); Cipollone v. Liggett Group, Inc., 789 F.2d 181, 187 (3d Cir. 1986), cert. denied 107 S. Ct. 907 (1987) (same). The court of appeals' ruling in the present case conflicts with these recent decisions.

3. The Federal Financial Institution Regulatory Scheme

Based on the fiscal powers of Congress to provide for general welfare, the federal government has the power to provide for and regulate a national system of banks and other financial institutions. M'Culloch v. Maryland, 17 U.S. (4 Wheat) 316 (1819). Federal savings and loan associations are in the class of federal banking institutions. Century Fed. Sav. & Loan Ass'n v. Sullivan, 116 N.Y.S.2d 323 (West. County Sup. Ct. 1952), modified 281 App. Div. 830, 118 N.Y.S. 2d 479

The statutory foundation for individual banks and savings and loan associations is set out in several acts[4]. With

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[4] Federal Reserve Act of 1913, 12 U.S.C. § 221-522; National Bank Acts, 12 U.S.C. §§ 21-24, 25a-29, 35-37, 39, 51, 52, 53, 55-57, 59-62, 66, 71, 72-76, (Footnote Continued)

respect to federal savings and loans, the Federal Home Loan Bank Board is empowered to promulgate regulations to implement the applicable statutes[5]. Proper rules and regulations of the Federal Home Loan Bank Board have the force and effect of law. See Fidelity Federal Sav. & Loan Ass'n v. de la Cuesta, 548 U.S. at 153-154.

(Footnote Continued)
81-91, 93, 94, 101a, 102, 104, 107-110, 123, 124, 131-138, 141-144, 151, 152, 161, 168-175, 181-186, 192-196, 4891-485, 501, 541, 548 and 582; Federal Home Loan Bank Act, 12 U.S.C. §§ 1421-1449; Home Owners' Loan Act of 1933, 12 U.S.C. §§ 1461-1470.

[5] In regard to savings and loan associations, "Congress expressly delegated the duty and authority to the Home Loan Bank Board to make policy, including power to make rules and regulations for the organization, incorporation, examination, operation, supervision and regulation of savings and loan associations, which delegation is constitutional." California v. Coast Fed. Savings & Loan Ass'n, 98 F. Supp. 311, 316 (D.C. Cal. 1951).

Federal savings and loan associations can exercise only the powers expressly granted to them by the federal statutes and regulations which implement the instrumentalities, and such incidental powers as are necessary to conduct their ordinary business. A federal association has implied power to do things reasonably incident to the accomplishment of its express powers; however, a power that federal law, by fair construction, denies to a federal instrumentality cannot exist incidentally. See Century Fed. Sav. & Loan, 116 N.Y.S.2d at 327.

A state cannot increase the powers of federal instrumentalities by adding any powers other than "those expressly granted or fairly implied in the act authorizing [their] creation." Myers v. Exchange Nat'l Bank, 96 Wash. 244, 164 P. 951 (1917). Moreover, banking laws "being

laws relating to a special subject, are paramount to general laws inconsistent with them." 1 A.D. Kowalsky, R.W. Wolter, and M.J. Divine, Michie on Banks and Banking, 28 (1986)[6]. It follows that a court construing may not apply a general equitable principle to allow a financial institution to circumvent the requirements of a specific federal banking regulation.

4. Statutory and Regulatory Framework of the Present Case

In the present case the trial court granted the financial institution the right to proceed as subrogee to the rights of its three officers, whom the association had indemnified without regard to the specific requirements of applicable federal regulations. The court of appeals

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[6] See also Hanson v. Sogn, 50 S.D. 44, 208 N.W. 228 (1926); Kimbriel v. State, 106 Okla. 177, 233 P. 420 (1924).

subsequently affirmed the trial court's decision regarding subrogation observing that if petitioner had wished to preclude subrogation claims, it could have so provided in the policy. (Pet. App. 17a). The court's observation, while correct, ignores the principle of federal preemption. The issue is not whether, as a matter of contract interpretation, respondent could ever assert a subrogation claim under insuring agreement (a) of the policy. Such a claim might well be permissible if it were not asserted, as it was here, to circumvent Bank Board regulations. Rather, the issue is whether, as a matter of federal law, application of state law subrogation principles is preempted by the Bank Board's regulations.

The present preemption question is based on the Home Owners' Loan Act of 1933 (HOLA), 12 U.S.C. §§ 1461-1470. Pursuant

to the authority granted by HOLA, the Bank Board unequivocally provided that its regulations would preempt state law.

> The regulations in this Part 545 are promulgated pursuant to the plenary and exclusive authority of the Board to regulate all aspects of the operations of Federal associations, as set forth in section 5(a) of the Home Owners' Loan Act of 1933. 12 U.S.C. 1464, as amended. This exercise of the Board's authority is preemptive of any state law purporting to address the subject of the operations of a Federal association.

12 C.F.R. § 545.2. (Emphasis supplied.)

In commenting on this extremely broad provision, the Bank Board made it clear that federal preemption was a critical part of its overall regulatory scheme:

> Federal Preemption
> The proposal included a new section stating specifically the Board's intent that these regulations preempt state law. The preemptive effect of the Board's regulations has been amply recognized by the courts; it derives from and is an integral part of the Board's exercise of its authority under

> Federal law. Although a statement is unnecessary to give these regulations preemptive effect, the Board desires to make clear its views on the preemptive nature of the authority conferred on Federal associations by the HOLA and the Board's regulations.

48 Fed. Reg. 23032-23033 (1983). Thus, there can be no doubt regarding the Bank Board's intent to preclude all state regulation of the operation of federal savings and loan associations.[7]

The Bank Board's requirements for a federal association to indemnify its directors, officers, and employees are set forth in 12 C.F.R. § 545.121. With respect to expenses related to settling claims asserted against officers and

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[7] The exclusiveness of the provisions is emphasized in 12 C.F.R. § 545.121(f): "No association shall indemnify any [director, officer, or employee] ... other than in accordance with this section."

directors, the regulations provide that indemnification shall be made only if:

> a majority of the disinterested directors of the association determine that he was acting in good faith within the scope of his employment or authority as he could reasonably have perceived it under the circumstances and for a purpose he could reasonably have believed under the circumstances was in the best interests of the association or its members. However, no indemnification shall be made unless the association gives the Board at least 60 days' notice of its intention to make such indemnification.

12 C.F.R. § 545.121(c). The court of appeals held that respondent failed to comply with the 60 days' notice requirement (Pet. App. 15a, fn. 5).

Paragraph (e) of the same regulation discusses the payment of expenses as follows:

> Before making advance payment of expenses under this paragraph, the association shall obtain an agreement that the association will be repaid if the person on whose behalf payment is made is later determined not to be

> entitled to such indemnification.

12 C.F.R. § 545.121(e). The court of appeals also found that respondent failed to comply with this Bank Board requirement. (Pet. App. 15a, fn. 5).

The holding of the trial court and the court of appeals, that a federal association can ignore the federal regulatory scheme and proceed as subrogee to the rights of the officers whom it unlawfully indemnified, is plainly contrary to and preempted by 12 C.F.R. § 545.121. If uncorrected, the court of appeals' opinion may erode the federal preemption principle and the Bank Board's regulatory scheme.

CONCLUSION

For the foregoing reasons, the writ should be granted.

Respectfully submitted,

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DATED: April 27th, 1988.

APPENDICES

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 87-1572

Atlantic Permanent Federal
Savings and Loan Association,

Plaintiff-Appellee,

versus

American Casualty Company
of Reading, Pennsylvania,

Defendant-Appellant.

Appeal from the United States District Court for the Eastern District of Virginia, at Norfolk. Richard B. Kellam, Senior District Judge. (CA-86-172-N)

Argued November 4, 1987. Decided February 12, 1988

Before RUSSELL and PHILLIPS, Circuit Judges, and HAYNSWORTH, Senior Circuit Judge.

John Bowers McCammon (Edward E. Nicholas, III; Wright, Robinson, McCammon & Tatum [sic], P.C.; Steven S. Radin; Kenneth F. Oettle; Davis J. Howard; Sills, Beck, Cummis, Zuckerman, Radin, Tischman & Epstein on brief) for Appellant; Walkley

Elmes Johnson, Jr. (Crenshaw, Ware & Johnson on brief) for Appellee.

PER CURIAM:

American Casualty Company (American) appeals a judgment against it in an action for breach of a directors' and officers' liability insurance policy that American issued to Atlantic Permanent Federal Savings and Loan Association (Atlantic). We find no reversible error and affirm.

I

The policy at issue contains two parts. Clause A provides direct coverage for Atlantic's individual officers and directors.[1] Clause B insures Atlantic

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[1] Clause A provides:

[The Insurer agrees] [w]ith the Directors and Officers of the [Savings and Loan] Association that if, during the policy period any claim or claims are made against the Directors and Officers, individually or collectively, for a Wrongful Act, the Insurer will pay, in accordance with the terms of this policy, on behalf of the Directors and Officers or

(Footnote Continued)

itself against certain indemnification payments it makes to individual officers or directors.[2] The policy was initially issued in 1973. In February of 1984, Atlantic made application on American's form to renew the policy for a one-year period beginning March 1, 1984. Atlantic's application, which was signed by its chief executive officer, Edgar Everhart,

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(Footnote Continued)
any of them, their heirs, legal representatives or assigns, all Loss which the Directors and Officers or any of them shall become legally obligated to pay.

[2] Clause B provides:

[The Insurer agrees] [w]ith the [Savings and Loan] Association that if, during the policy period, any claim or claims are made agianst the Directors and Officers individually or collectively, for a Wrongful Act, the Insurer will pay, in accordance with the terms of this policy, on behalf of the Association, all Loss for which the Association is required to indemnify or for which the Association has, to the extent permitted by law indemnified the Directors and Officers.

contained the following question: "Has there been during the past policy period, or is there now pending, any suit against [Atlantic] or its subsidiaries?" Everhart answered "Yes" to this question and attached, by way of explanation, a copy of a letter from Atlantic's counsel, which purported to list all claims against Atlantic that were then pending or threatened. Though the letter accurately listed all pending and threatened claims against Atlantic, it did not reveal that several other claims, later settled, had been filed against Atlantic during the prior policy period. Based in part on this letter, American granted Atlantic's application for renewal.

In September of 1984, during the renewal period, several Atlantic loan customers filed suit against Atlantic, its subsidiary Colonial Services Corp.

(Colonial), and three of Atlantic's officers - Willis Stephenson, Harry Knickerbocker, and Warren Fisher. The loan customers alleged that the defendants had engaged in various fraudulent and deceptive sales tactics in connection with Atlantic's home improvement loan program. Atlantic retained its general counsel, Crenshaw, Ware & Johnson, to defend Atlantic, Colonial, and officers Knickerbocker and Fisher. The remaining officer, Stephenson, employed the firm of Williams, Worrell, Kelly & Greer to defend him.

In July of 1985, the loan customers agreed to settle their claims against all five defendants for $115,000 plus $538,407 in attorney's fees. Atlantic's Board of Directors approved the settlement and agreed to indemnify the three officers named as defendants for all costs of defense and settlement. Atlantic

accordingly paid the loan customers $115,000 in settlement and $538,407 in attorney's fees. Atlantic also paid $481,563 to Crenshaw, Ware for the defense of Atlantic, Colonial, and officers Knickerbocker and Fisher, and $303,001 to Williams, Worrell for the defense of Stephenson. Atlantic then made demand upon American for these expenses, which it claimed were covered by its directors' and officers' liability insurance policy. When American denied coverage, Atlantic filed this action for breach of contract.

American asserted five basic defenses to coverage: (1) that the policy renewal was void because it was procured through a material misrepresentation; (2) that Atlantic has no standing to sue under the policy, because the losses claimed were not covered by Clause B and it had no right to proceed under Clause A; (3) that

the losses claimed fell within a policy exclusion for dishonest conduct; (4) that the losses claimed stemmed from the officers' intentional wrongdoing, which was uninsurable as a matter of public policy; and (5) that even if there was coverage, it was limited to that portion of the defense and settlement costs which had been incurred on behalf of the three insured officers, as opposed to Atlantic and Colonial.

The district court eliminated two of these defenses at the summary judgment stage, ruling that Atlantic was entitled to proceed under Clause A as subrogee to the rights of the insured officers who expenses it had paid, and that the dishonesty exclusion was inapplicable to that claim. The case then proceeded to trial before a jury. At the close of Atlantic's evidence, American made a motion for

directed verdict, which it renewed at the close of all the evidence. The motion contended, inter alia, that Atlantic had failed adequately to prove its damages. The district court delayed ruling on the motions and submitted the case to the jury for special verdict on a number of issues, including: (1) whether the renewal application contained a misrepresentation of fact of which officers Stephenson, Knickerbocker, and Fisher were aware, and (2) what portion, if any, of the expenses sought had been incurred on behalf of the insured officers, as opposed to Atlantic and Colonial. The jury found that there had been no knowing misrepresentation on the part of the three officers, and that $947,536 of the $1,437,971 in expenses claimed were allocable to them. The district court thereupon entered judgment for Atlantic in that amount. American

filed a motion for judgment notwithstanding the verdict or, in the alternative, a new trial, on the grounds raised in the earlier motions for directed verdict. The district court denied this motion. American then moved under Fed. R. Civ. P. 59(e), to amend the verdict to reflect the policy's $10,000 deductible, which it claimed should be applied multiple times. The district court granted the motion to amend, but applied the deductible only once, reducing the judgment to $937,536. This appeal followed.

II

A

American first argues that the district court erred in instructing the jury that any misrepresentations in the renewal application would bar Atlantic's recovery only if American proved that the individual officers in whose shoes

Atlantic stood as subrogee had knowledge of them.[3] Under Virginia law, which governs the interpretation of this contract,[4] a misrepresentation of fact in an insurance application renders the policy

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[3] The court instructed the jury as follows:

Now, you are to determine whether or not a false statement was made and whether the three officers in question knew of it, because the policy issued itself carries a provision. The wrongful act of any director or officer shall not be imputed to any other director or officer for the purpose of determining the applicability of whether the policy may be excused. So keep that only in mind as to that fact.

[4] In this diversity case, the district court was required to apply the choice-of-law rules of the state in which it sat - Virginia - in deciding which state's substantive law to apply to this contract. Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487 (1941). In Virginia, the interpretation of a contract is governed by the law of the place where it was made, absent an express contract provision to the contrary, C.I.T. Corp. v. Guy, 195 S.E. 659 (Va. 1938). Since this insurance contract was made in Virginia, Virginia law governs its interpretation.

void if the misrepresentations were material to the risk when assumed. Va. Code Ann. § 38.2-309 (1986). The Virginia Supreme Court has, however, specifically upheld provisions in insurance policies that limit the insurer's right to void the policy for misrepresentation. See, e.g., Sterling Ins. Co. v. Dansey, 81 S.E. 2d 446 (Va. 1954) (enforcing clause providing that coverage could not be avoided unless misrepresentation in application was made with knowledge of its falsity). This particular insurance policy contained such a provision: paragraph 7(a) expressly provided that "this policy shall not be voided or rescinded and coverage shall not be excluded as a result of any untrue statement in the [application] form, except as to those persons making such statement or having knowledge of its untruth." American seeks to avoid the

impact of this provision by arguing that any misrepresentations made in the renewal application, whether by these officers or by others, rendered the entire policy void from the moment of signing. American argues that paragraph 7(a) therefore affords no protection to Atlantic, as subrogee to the rights of the "innocent" officers, because it never became effective.

We reject this argument. Paragraph 7(a) was plainly designed to prevent misrepresentations made by the particular officers responsible for preparing an application form from depriving their innocent colleagues of coverage, and to refuse to give it effect here would undermine the parties' manifest intent. The language of the policy is plain and unambiguous, and we are obligated to apply it, absent a showing that it is in

violation of law or inconsistent with public policy. See Sterling Ins. Co. v. Dansey, 81 S.E.2d at 450. Though paragraph 7(a) provides the insured officers with greater protection than would otherwise be available to them under the law of Virginia, we have not been shown that it is inconsistent with any express public policy of that state.

B

American next contends that the district court erred in ruling, on summary judgment, that Atlantic was entitled to proceed against it under Clause A of the policy, as subrogee to the rights of the insured officers whose defense and settlement expenses Atlantic had paid.[5]

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[5] Atlantic was not entitled to proceed against the insurer in its own right, under Clause B of the policy. Clause B (Footnote Continued)

American concedes that Atlantic did in fact pay these expense and that, under

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(Footnote Continued)
insures Atlantic itself against those losses "for which [it] is required to indemnify, or for which [it] has, to the extent permitted by law, indemnified the Directors and Officers" (emphasis added). As a federally insured savings and loan, Atlantic was required to indemnify its officers and directors for losses incurred in the defense and settlement of actions brought against them in their official capacity, but was permitted to do so only in accordance with certain procedures prescribed by the Federal Home Loan Bank Board (FHLBB). See 12 C.F.R. § 545.121 (1985). The undisputed facts establish that Atlantic failed to comply with these procedural requirements in two respects: it did not give the FHLBB 60 days advance notice of its intention to indemnify the officers, as required by 12 C.F.R. § 545.121(c)(2), and it advanced defense and settlement costs to the officers without requiring them to sign a written agreement to make restitution in the event they were later found not entitled to indemnification, in violation of 12 C.F.R. § 545.125(e). Because of these violations of applicable federal regulations, Atlantic's indemnification of officers Stephenson, Knickerbocker, and Fisher was not "permitted by law," and it was therefore precluded from recovering directly from the insurer under Clause B.

normal principles of subrogation, it would thereby succeed to any rights that the officers themselves might have against American under the policy. American contends, however, that it was error to allow subrogation in this case, for two basic reasons. We find neither persuasive.

First, American argues that the contract itself either expressly or by implication limited Atlantic's rights against the insurer to those available to it under Clause B - that is, that Clause B was intended to "preempt" any subrogation rights that Atlantic might otherwise have at common law. We disagree. Clause B does provide Atlantic with greater rights against American than it would have as common law subrogee, for the various exclusions from coverage set forth in paragraph 3(a) are specifically

inapplicable to claims made under it. But nothing in the language of Clause B indicates that it was intended to nullify any common law rights of subrogation that Atlantic might have against the insurer. Had American wished Clause B to have this effect, it could have said so expressly. Having failed to do so, it cannot look for relief to the courts, which are bound in cases of doubt to construe the contract against the insurer. See St. Paul Fire & Marine Ins. Co. v. S.L. Nusbaum & Co., 316 S.E.2d 734, 736 (Va. 1984).

Second, American argues that allowing Atlantic to proceed as common law subrogee would violate the general principle that equitable relief should not be granted to one with unclean hands, here by permitting Atlantic to recover under an insurance policy that it procured through material misrepresentations. Again, we disagree.

It is true that, under Virginia law, as generally, subrogation is not a matter of absolute right but an equitable remedy whose availability depends upon the facts and circumstances of the particular case. Federal Land Bank v. Joynes, 18 S.E.2d 917, 920 (Va. 1942); see National Valley Bank v. United States Fidelity & Guaranty Co., 150 S.E. 403 (Va. 1929) (right of subrogation denied because of laches). But the essential purpose of the doctrine of subrogation is to secure the ultimate discharge of a debt by the party who ought in equity to pay it, notwithstanding the technical failure to take an assignment. See Federal Land Bank v. Joynes, 18 S.E.2d at 923. In this case, we think it plain that the ultimate burden of paying the defense and settlement costs incurred by officers Stephenson, Knickerbocker, and Fisher should rest in equity upon

American, which expressly obligated itself by contract to provide them with liability insurance coverage even if their colleagues made material misrepresentations in the insurance application, so long as they themselves were unaware of those misrepresentations. To allow American to escape this obligation, for which it was certainly well compensated, by somehow imputing the misconduct of the officers who prepared the application to Atlantic itself would be manifestly unjust. Such a result would not only undermine the fundamental purpose of the doctrine of subrogation, but also be inconsistent with Virginia's long-standing commitment to liberal application of that doctrine. See Thompson v. Miller, 79 S.E.2d 643, 647 (Va. 1954); Federal Land Bank v. Joynes, 18 S.E.2d at 920. The district court did

not err in granting summary judgment on this issue.

C

American then argues that the district court erred in ruling, on summary judgment, that the dishonesty exclusion set forth in paragraph 3(a)(5) of the policy[6] was inapplicable because there had

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[6] Paragraph 3(a)(5) of the policy specifically excluded from coverage any loss that was

> brought about or contributed to by the dishonesty of the Directors or Officers. However, notwithstanding the foregoing, the Directors or Officers shall be protected under the terms of this policy as to any claims upon which suit may be brought against them, by reason of any alleged dishonesty on the part of the Directors or Officers, unless a judgment or other final adjudication thereof adverse to the Directors or Officers shall establish that acts of active and deliberate dishonesty committed by the Directors or

(Footnote Continued)

not been a final adjudication of deliberate dishonest conduct in the underlying action against the officers. The district court held that paragraph 3(a)(5) did not prevent the officers from recovering for losses caused by their dishonest behavior unless it was established in the underlying action itself, rather than a subsequent coverage suit, that they had committed "acts of active and deliberate dishonesty. . .with actual dishonest purpose and intent." The district court reasoned that the phrase "a judgment or other final adjudication thereof" was intended to refer only to "claims upon which suit may be brought against [the officers] by reason of [their] alleged dishonesty."

(Footnote Continued)
Officers with actual dishonest purpose and intent were material to the cause of action so adjudicated.

American contends here that this interpretation renders the dishonesty exclusion virtually meaningless because it permits officers to recover the cost of defending claims based on their dishonest behavior simply by settling those claims before trial. In American's view, the first sentence of paragraph 3(a)(5) gives the insurer an absolute right to avoid coverage, regardless of the outcome of the underlying litigation, by establishing in a subsequent coverage action that the insured officers committed "acts of active and deliberate dishonesty. . .with actual dishonest purpose and intent." The "however" clause, it argues, was intended only to make clear that mere allegations of dishonesty in the underlying action would not suffice to trigger the exclusion.

While we agree that the contract provision is ambiguous, a finder of fact seeking to resolve the ambiguity would be bound to construe the exclusion strictly against the insurer. See St. Paul Ins. Co. v. S.L. Nusbaum & Co., 316 S.E.2d at 736. Because we think a finder of fact thus constrained could reasonably interpret the provision only as did the district court, we conclude that the district court did not err in ruling on summary judgment that the exclusion was inapplicable. See Pepsico, Inc. v. Continental Casualty Co., 640 F. Supp. 656 (S.D.N.Y. 1986) (rejecting, on summary judgment, precisely the same argument made by insurer as to identical exclusion language).

D

American's next contention is that it should have been entitled to avoid

coverage on the ground that conduct giving rise to the losses claimed was the sort of "intentional wrongdoing" that is uninsurable under Virginia law. This argument is without merit. The "wrongdoing" of which others here were accused was failure adequately to supervise the activities of dishonest contractors whose sales they financed. Virginia courts have never extended the "intentional wrongdoing" defense to conduct which, though itself "intentional," was not intended to cause injury. Instead, the defense has been confined to cases where the insured acted with the specific intent to cause harm. See, e.g., Fedele v. National Liberty Ins. Co., 35 S.E.2d 766 (Va. 1945) (pouring gas on an automobile and setting it on fire). Indeed, to adopt American°s argument would be to render liability insurance virtually meaningless, for it would mean that the

insured could never recover for harm caused by an act that was itself intentional - i.e., driving a car - even if that act was not specifically intended to cause injury, but was merely reckless or negligent as to the possibility that injury would occur. For this reason, we conclude that the district court did not err in ruling, as a matter of law, that the losses claimed were not for this reason uninsurable.

E

After the jury returned its verdict for Atlantic, American once again asserted, by way of a motion for judgment notwithstanding the verdict or, in the alternative, a new trial, its defense that Atlantic had failed adequately to prove its damages. The district court denied both motions, and American claims this was error.

Atlantic sought recovery under the policy for the following expenses incurred in the course of defending and settling the loan customers' claims:

> $115,000 paid to the loan customers themselves in settlement;
>
> $538,407 paid to the loan customers' attorneys;
>
> $303,001 paid to Williams, Worrell for the defense of Stephenson;
>
> $481,563 paid to Crenshaw, Ware for the defense of Atlantic, Colonial and the two remaining officers, Knickerbocker and Fisher; totalling $1,437,971.

American was, of course, responsible for only those expenses that were reasonably allocable to the defense and settlement of the claims against the three insured officers, as opposed to Atlantic and its subsidiary Colonial. The jury returned a verdict of $947,536.89 for Atlantic, allocated as follows: $411,902.50 for

expenses incurred on behalf of Stephenson and $35,634.39 for expenses incurred on behalf of Knickerbocker and Fisher.

American asserts that Atlantic failed to carry its burden of proof in two respects: it failed to present sufficient evidence that the settlement costs ($115,000 plus $538,407 in attorney's fees) and the $481,563 Crenshaw, Ware fee were properly allocable to the insured officers, and it failed to present sufficient evidence that the attorney's fees paid to Williams, Worrell and Crenshaw, Ware were reasonable. American therefore challenges the district court's refusal to disturb the verdict to the extent that it represents reimbursement for settlement expenses and legal fees, a figure which it

estimates at $947,536.89.[7] This would, of course, leave nothing standing of the $937,536 verdict. In the alternative, American asks that it be granted a new trial on damages.

We address first the propriety of the district court's denial of the motion for

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[7] American arrived at this figure in the following manner. Because Williams, Worrel defended only the insured officer Stephenson, all $303,001 of the payment to it was covered by the policy. The remaining $108,901.50 of the $411,902.50 Stephenson award was therefore for unallocated settlement expenses and should be set aside. Of the $481,563.39 paid to Crenshaw, Ware, only $120,390.75 was for the defense of Fisher and Knickerbocker (according to American's expert witness). The remaining $415,243.64 of the $535,634.39 award for expenses incurred on behalf of Fisher and Knickerbocker was therefore for unallocated settlement expenses and should be set aside. All told, then, American claims that $524,145.14 of the verdict ($108,901.50 - $415,243.64) represented unallocated settlment costs, and that $423,391.75 represented allocated but unreasonable attorney's fees.

judgment notwithstanding the verdict. A district court may properly grant a motion for judgment notwithstanding the verdict only when the evidence, viewed in the light most favorable to the nonmoving party, cannot support a verdict in that party's favor. See Lust v. Clark Equip. Co., 792 F.2d 436, 437-38 (4th Cir. 1986). If there is sufficient evidence from which a jury could reasonably have returned the verdict it did, the motion must be denied. Id. Applying this standard, we conclude that there was sufficient evidence to support the damages awarded here.

Under Virginia law, a plaintiff has the burden of proving the amount of his damages with reasonable certainty, but he is not required to do so with mathematical precision; he need only present sufficient evidence "to permit an intelligent and probable estimate thereof." Gwaltney v.

Reed, 84 S.E.2d 501, 501-02 (Va. 1954). See Hailes v. Gonzales, 151 S.E.2d 388 (Va. 1966). At trial, Atlantic presented the following evidence that the settlement expenses were properly allocable to the insured officers: the policy itself, which defined the "loss" against which the officers were insured as "any amount which [they] are legally obligated to pay," and the settlement agreement, which provided that each of the defendants, including the three insured officers was legally obligated for the full amount of the settlement. We think this evidence was sufficient to justify submission of the claim for settlement expenses to the jury.

Nor do we agree that Atlantic failed to submit sufficient evidence that the attorney's fees claimed were reasonable to justify the submission of that item of damages to the jury. Atlantic introduced

both itemized bills from the attorneys and evidence showing that the bills had been paid. The district court found that this evidence was sufficient to raise a presumption that the amounts charged were reasonable , and we do not think this was error. We have been unable to locate any Virginia cases dealing with the precise question of what is sufficient evidence to get to the jury on a claim for attorney's fees under a liability insurance policy. The case most nearly on point, Walters v. Littleton, 290 S.E.2d 839 (Va. 1982), holds only that the presentation of medical bills regular on their face may be sufficient to create a jury question on the reasonableness of those charges, depending on the facts of the particular case. Id. at 842. But cases in other jurisdictions hold that the introduction of a paid bill, supported by testimony of

the claimant or his agent, is sufficient to create a prima facie case that an expense claimed as damages under an insurance policy was reasonable. See e.g. Eureka Inv. Corp. v. Chicago Title Ins. Co., 743 F.2d 932 (D.C. Cir. 1984). Once the claimant presents such evidence, the burden or production then shifts to the insurance company to go forward with evidence showing that the charge was not reasonable. Id. at 942. We assume that a Virginia court faced with the issue would follow this general rule. If so, the evidence presented here was sufficient to get to the jury on the claim for attorney's fees. Atlantic introduced fully itemized bills for all legal expenses claimed and presented evidence that it had paid those bills. Kenneth Lambert, a member of the firm who represented Mr. Stephenson, testified at length about the

amount of work he had done in defending Stephenson. American offered no evidence to rebut the presumption that the fees charged were reasonable. ON this record, we think the district court was justified in submitting the claims for legal fees to the jury, for a reasonable jury could certainly have found that the fees claimed were reasonable. The district court correctly denied the motion for judgment notwithstanding the verdict.

Similarly, we do not think the district court erred in denying American's motion for a new trial on the damages issue. The grant or denial of a motion for new trial is addressed to the sound discretion of the district court and will not be reversed on appeal absent a showing of abuse of discretion. See Wilhelm v. Blue Bell, Inc., 773 F.2d 1429, 1433 (4th Cir. 1985); see generally 11 C. Wright &

A. Miller, Federal Practice & Procedure: Civil § 2818, at 118-20 (1973). We find no abuse of discretion here.

F

American's next argument is that the district court erred in refusing to apply more than one deductible to reduce the judgment. The deductible (or "retention") provision, which appears in paragraph 4(a) of the policy, reads as follows:

> The insurer shall be liable to pay one hundred percent (100%) of any Loss. . .in excess of the retention amount shown under Item 4 of the Declarations. . . . One retention amount shall apply to each and every Loss.

Item 4 lists the retention amount as $10,000 for "each loss." The term "loss" is defined in paragraph 1(d) of the policy as follows:

> The term "Loss" shall mean any amount which the Directors and Officers are legally obligated to pay. . .for a claim or claims

> made against [them]. . .for <u>wrongful acts</u>.

(Emphasis added.) American argues that because each of the nine plaintiffs in the underlying action asserted seven causes of action against the insured officers, there were really 63 separate "losses" and $630,000 ought therefore to be deducted from the judgment. In the alternative, American argues that it is entitled to have the deductible applied nine times, because there were nine separate "losses," each encompassing seven claims arising out of a single loan transaction. The district court rejected both arguments, holding that when the claims asserted against the insured arise out of a series of interrelated acts - here, the planning and carrying out of Atlantic's home improvement loan program - they should be treated as a single "loss" for the purposes of calculating the deductible.

We do not think the district court erred in so interpreting the contract. Paragraph 1(d) of the policy specifically defines "loss" to include multiple claims. Paragraph 4(d) of the policy provides that, for the purpose of calculating the insurer's maximum coverage liability, "[c]laims based on or arising out of the same act, interrelated acts, or one or more series of similar acts. . .shall be considered a single loss." We think it highly unlikely that the parties intended the term "loss," which is given only one express definition, to have a different meaning in calculating the applicable deductible than it has in determining the insurer's maximum coverage. Finally, Virginia law requires us to construe all ambiguities in insurance contracts against the insurer and in favor of coverage. For these reasons, we conclude that the

district court did not abuse its discretion in refusing to apply the deductible more than once.

III

The remaining allegations of reversible error raised by American are without merit and do not require discussion. The judgment below is therefore affirmed.

AFFIRMED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Norfolk Division

ATLANTIC PERMANENT FEDERAL
SAVINGS & LOAN ASSOCIATION,

Plaintiff,

v. Civil Action No. 86-172-N

AMERICAN CASUALTY COMPANY OF
READING, PENNSYLVANIA,

Defendant.

ORDER

This matter comes before the Court on Motions for Partial Summary Judgment filed by both the plaintiff, Atlantic Permanent Federal Savings & Loan Association, and the defendant, American Casualty Company of Reading, Pennsylvania.

Plaintiff brings this action pursuant to 28 U.S.C. § 1332, diversity of citizenship, in its own right and as subrogee to the rights of three of its officers. The plaintiff is attempting to recover losses insured under a Directors and Officers

Liability Insurance Policy and Loan Blanket Bond issued by the defendant. The insured losses were incurred as a result of the defense and settlement of actions brought by a group of homeowners who contended that they had lost their homes through the foreclosure of deeds of trust held by the plaintiff. The homeowners alleged that the plaintiff and the three-named officers acted in concert with home improvement contractors in obtaining the deeds of trust through artifice, trickery or fraud.

Both parties have submitted briefs on the Motions and oral argument was held on October 2, 1986. Therefore, this matter is now ripe for the Court's consideration.

Initially, the Court would note that summary judgment under Rule 56 is only appropriate when the Court, viewing the record as a whole and in light most

favorable to the non-moving party, determines that there exists no genuine issue of material fact. Terry's Floor Fashions, Inc. v. Burlington Industries, Inc., 763 F.2d 604, 610 (4th Cir. 1985); Cahrbonnage de France v. Smith, 597 F.2d 406, 414 (4th Cir. 1979). The burden is on the moving party to demonstrate the absence of any genuine issues of material fact. Adickes v. S. H. Kress & Co., 398 U.S. 144, 157, 90 S. Ct. 1598, 1608 (1970). The Court will consider the defendant's Motion for Partial Summary Judgment first and then it will consider the plaintiff's Motion.

The defendant moves for partial summary judgment as to Counts III and V of the Complaint based on the recent decision of the Fourth Circuit Court of Appeals in A&E Supply Co. v. Nationwide Mutual Fire Insurance Co., No. 85-1759 (4th Cir. Aug. 15, 1986). In addition, the defendant

moves to have Count IV of the Complaint dismissed because rather than stating a right of action, it merely repeats the prayer for attorney's fees found in Counts I and II.

The Court finds that Count V of the plaintiff's Complaint should be dismissed in light of the holding in A&E Supply Co. The plaintiff in Count V attempts to assert a private cause of action under the Virginia Unfair Insurance Practices Act, Va. Code § 38.1-49. However, in A&E Supply Co. the Fourth Circuit held "that the Virginia Unfair Insurance Practices Act does not establish a private cause of action." A&E Supply Co. v. Nationwide Mutual Fire Insurance Co., No. 85-1759, slip op. at 13 (4th Cir. Aug. 15, 1986).

The plaintiff concedes that absent a Virginia Supreme Court decision to the contrary, then A&E Supply Co. controls as

to Count V. The Court, therefore, GRANTS the defendant's Motion for Partial Summary Judgment as to Count V of the Complaint and DISMISSES it with prejudice.

The second issue raised in the defendant's Motion is that to the extent that Count III of the plaintiff's Complaint alleges a tort of insurer bad faith and seeks punitive damages, it should be dismissed. The defendant relies again on A&E Supply Co. which held that in the context of a first-party insurance obligation, Virginia does not recognize the tort of insurer bad faith. The plaintiff asserts that because A&E Supply Co. involved a first-party insurance obligation, it should not be controlling in this case which involves a third-party insurance obligation.

The Court finds that although A&E Supply Co. dealt with a first-party

insurance obligation in holding that Virginia does not recognize the tort of insurer bad faith, the holding equally applies in the context of a third-party obligation.

The Fourth Circuit observed that its ruling in A&E Supply Co. was entirely consistent with the Virginia Supreme Court's ruling in Aetna Casualty Surety Co. v. Price, 206 Va. 749, 146 S.E.2d 220 (1966) which held that a liability insurer must pay an excess judgment if the insurer refuses in bad faith to settle within the policy limits. A&E Supply Co., slip op. at [sic] 25. The Court also stated that the Aetna v. Price decision was grounded in contract and the excess judgment represented consequential damages arising from the alleged breach and not punitive damages for bad faith breach of an insurance contract. Id. Furthermore, the

Court in A&E Supply Co. stated that "[n]o Virginia authority indicates that punitive damages are available in the third-party context." Id. (Cf. Swiatlowski v. State Farm Mutual Auto Insurance Co., 585 F. Supp. 965 (W.D. Va. 1984) (holding that Aetna v. Price was not on all fours with other jurisdictions which have recognized the independent tort of insurance bad faith in the third-party context and withhold judgment on the issue of punitive damages.))

For the foregoing reasons, the Court GRANTS the defendant's Motion for Partial Summary Judgment as to Count III of the plaintiff's Complaint insofar as the plaintiff seeks to recover punitive damages under an independent tort of insurer bad faith.

The third issue raised by the defendant in its Motion for Partial Summary

Judgment is that Count IV of the Complaint should be dismissed because it does not state a separate claim but rather repeats a request for attorney's fees under Va. Code § 38.1-32.1.[1] The defendant asserts that it is unnecessary for the plaintiff to request attorney's fees in Count IV of the Complaint because a request was made in both Counts I and II.

The Court finds that plaintiff is seeking attorney's fees under Counts I and II based on common law principles and it is proper for the plaintiff to alternatively seek them under Va. Code § 38.2-209. The Court, therefore, DENIES the defendant's Motion for Partial Summary

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[1] Effective July 1, 1986, Section 83.1-32.1 was replaced by Va. Code § 38.2-209.

Judgment as to Count IV of the plaintiff's Complaint.

The plaintiff, in its Motion for Partial Summary Judgment, seeks to resolve two issues. First, its right to proceed as subrogee to the rights of its three officers, and second that any issue as to dishonesty under Exclusion (a)(5) of the Directors and Officers Policy is moot by reason of the settlement of the underlying action.

Under the Directors and Officers Liability Policy, insuring agreement (a), the defendant undertakes to repay any director or officer of an insured association any losses which they become obligated to pay by reason of claims asserted against them in their capacity as directors or officers. In this case, two officers and one former officer of the plaintiff company, all of whom qualified

as insureds under the policy, engaged counsel to defend them and eventually entered into a settlement agreement. The plaintiff paid the officers' costs of defense and ultimately paid the officers' part of the settlement because the defendant would not advance the costs as required under its policy. The plaintiff is now seeking to proceed against the defendant as subrogee.

Under Virginia law, where a person pays another's debt out of legal duty or to protect himself against losses he might suffer if the debt were not paid, subrogation is allowed. Morgan v. Gollehon, 153 Va. 246, 149 S.E. 485 (1929). In Collins v. Blue Cross, 213 Va. 540, 193 S.E.2d 782, 785 (1973), the Supreme Court of Virginia stated that "[t]he general right of subrogation has long been recognized and favored in Virginia." Citing Federal

Land Bank v. Joynes, 197 Va. 394, 18 S.E.2d 917 (1942); McKay v. Citizens Rapid Transit Co., 190 Va. 851, 859, 59 S.E.2d 121, 124 (1950). The Court in Collins stated that "[s]ubrogation is a device of equity designed to obtain an equitable adjustment between the parties by securing the ultimate discharge of a debt by the person who in equity ought to pay it." Collins v. Blue Cross, 193 S.E.2d at 784.

The officers of Atlantic Permanent have a right to proceed against the defendant under insuring agreement (a) for any costs of defense or settlement incurred by them; therefore, under the principal of subrogation, the plaintiff should be entitled to whatever cause of action inured to the benefit of its officers. The Court finds that to the extent that the officers have a right to proceed against the defendant, so too

should the plaintiff under the principle of subrogation.

The Court, therefore, GRANTS the plaintiff's Motion for Partial Summary Judgment as to the issue of the plaintiff proceeding as subrogee against the defendant.

The second issue raised in the plaintiff's Motion for Partial Summary Judgment is that it contends that any issue as to the dishonesty of the officers under Exclusion (a)(5) of the Policy is moot by reason of the settlement of the underlying action. The exclusion reads as follows:

> "The insurer shall not be liable to make any payment for loss in connection with any claim made against the Directors or Officers. . .brought about or contributed to by dishonesty of the Directors or Officers. However, notwithstanding the foregoing, the Directors or Officers shall be protected under the terms of this policy as to any claims upon which suit

> may be brought against them, by reason of any alleged dishonesty on the part of the Directors or Officers, unless a judgment or other final adjudication thereof adverse to the Directors or Officers shall establish that acts of active and deliberate dishonesty committed by the Directors or Officers with actual dishonest purpose and intent were material to the cause of action so adjudicated."

Exhibit 1 of Defendant's Rebuttal Brief.

The defendant asserts that regardless of the settlement of the underlying claims, it has a right to separately litigate the coverage issue with respect to the exclusion for the officers' alleged dishonesty. However, the plaintiff asserts that under the language of the exclusion, dishonesty must have been finally adjudicated in the underlying action. The plaintiff relies on Pepsico, Inc. v. Continental Casualty Co., No. 85 Civ. 5518-CLB (S.D. N.Y. June 23, 1986),

where a similar issue involving the same dishonesty exclusion was dealt with.

In Pepsico, Inc., the Court rejected Continental's argument that coverage could be precluded by the dishonesty exclusion. The Court stated that the exclusion for dishonesty attaches only after a final judgment or other final adjudication implicates the directors and such a finding would no longer be possible because the underlying action had been settled. Pepsico, Inc., op. at 8. The Court held that Continental cannot now put the directors and officers on trial to determine whether or not they were dishonest to the point that the policy would not cover them. Id. at 8 and 9.

The defendant asserts that Stargatt v. Avenall, 434 F. Supp. 234 (D. Del. 1977) should be controlling. However, in Pepsico, Inc. the Court distinguished

Stargatt and held that the dishonesty exclusion in the Stargatt policy was unconditional and did not predicate its applicability upon a final judgment or other final adjudication as did the exclusion in Pepsico, Inc. Pepsico, Inc., op. at 9. The exclusion for dishonesty in both Pepsico, Inc. and in the instant action are the same; therefore, this Court is persuaded by the decision in Pepsico, Inc. v. Continental Casualty Co., No. 85 Civ. 5518-CLB (S.D. N.Y. June 23, 1986).

The Court finds that under the Directors and Officers Policy issued by the defendant, the exclusion for the dishonesty of the directors and officers must have been finally adjudicated in the underlying action in order for the defendant to assert it as an exclusion under the policy. The Court is of the opinion that the wording of the exclusion supports

this result. The language which the Court relies on is "unless a judgment or other final adjudication thereof adverse to the Directors or Officers shall establish. . . ."

The word "thereof" refers to the suit against the directors and officers and unless there is a judgment adverse to them in the underlying suit, then the exclusion does not apply. The Court, therefore, GRANTS the plaintiff's Motion for Partial Summary Judgment with respect to the defendant asserting Exclusion (a)(5) under the policy. For the foregoing reasons, the Court GRANTS the defendant's Motion for Partial Summary Judgment as to Count V of the plaintiff's Complaint and DISMISSES it with prejudice. With respect to Count III of the plaintiff's Complaint, the Court GRANTS the defendant's Motion insofar as the plaintiff seeks punitive

damages for a tort of insurer bad faith. The Court DENIES the defendant's Motion for Partial Summary Judgment as to Count IV of the Complaint. With respect to the plaintiff's Motion for Partial Summary Judgment, the Court GRANTS the Motion as to both issues. The parties are DIRECTED to proceed for trial on this matter accordingly.

The Clerk is DIRECTED to send a copy of this Order to counsel for the plaintiff and defendant.

IT IS SO ORDERED.

_____
United States District Judge

Norfolk, Virginia
October 20, 1986

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Norfolk Division

ATLANTIC PERMANENT FEDERAL
SAVINGS & LOAN ASSOCIATION,
Plaintiff,
vs. CIVIL ACTION NO.
86-172-N
AMERICAN CASUALTY COMPANY
OF READING, PENNSYLVANIA,
Defendant.

OPINION AND ORDER

This matter is before the court on defendant's motion to set aside the verdict of the jury and enter judgment for defendant notwithstanding the verdict, or grant defendant a new trial. Tried to the jury, it returned a verdict in favor of the plaintiff for a part of the sums sought by it, and in favor of defendant on some others. The parties have submitted briefs and also argued the matter orally.

Much of defendant's argument deals with matters decided by the jury on conflicting evidence. While there was

some evidence supporting defendant's contention, there was substantial credible evidence supporting the findings of the jury. On a motion for judgment n.o.v. or for a new trial, the evidence is to be viewed in the light most favorable to the party with the verdict, and the verdict holder is to be given the benefit of all reasonable inferences from the evidence. Hill v. BASF Wyandotte Corp., 782 F.2d 1212, 1213 (4th Cir. 1986); Gill v. Rollins Protective Services Co., 773 F.2d 592, 594 (4th Cir. 1985). In Gill, supra, the court points out the duty of the court in ruling on a motion for judgment notwithstanding the verdict and for a new trial. In the first instance, where there is substantial evidence to support the verdict, evidence of such quality and weight that reasonable and fair-minded persons in the exercise of impartial

judgment could reasonably return a verdict for the nonmoving party, the motion should be denied. Whereas, in the second instance, on a motion for a new trial, it is the duty of the court to weigh the evidence and the credibility of the witnesses to see whether the verdict is against the clear weight of the evidence or will result in a miscarriage of justice. That is, is the verdict against the clear weight of the evidence and unfair.

Defendant also moves the court to amend the verdict of the jury to reduce the findings pursuant to the deductible provisions of the policy. At the time of trial all parties were in accord that certain deductible provisions of the policy applied and that they would be applied by the court to any findings of the jury. They are hereafter dealt with.

I.

Atlantic Permanent Federal Savings and Loan Association (Atlantic) is a federally chartered savings and loan association with its principal offices in Norfolk, Virginia. Commencing in 1973, it purchased a Directors' and Officers' Liability Policy (Policy) from MGIC Indemnity Company. In 1983 CNA Financial Corporation (CNA) purchased MGIC. CNA also owns American Casualty Company of Reading, Pennsylvania (American). Commencing March 1, 1984, the Policy was written on a MGIC form, but coverage was assumed by American.

In 1984 Atlantic was also insured under a Savings and Loan Blanket Bond (Bond) written on a MGIC form with coverage assumed by American, effective November 1, 1983.

In September 1984, one Gregory and others filed an action against Atlantic and Colonial Service Corporation (Colonial), a wholly owned subsidiary of Atlantic, and Atlantic's former president. Later, two other officers of Atlantic were added as defendants. Plaintiffs sought without success, to have the suit declared a class action. Plaintiffs alleged they had lost their homes through foreclosures of loans made by Atlantic to cover improvements to their homes. Notice of the action was timely given to American advising them of their liability for coverage under the Policy and Bond. The allegations of the suit brought Atlantic and its officers within the coverage of Policy and Bond.

Stephenson, the former president of Atlantic, employed Williams, Worrell, Kelly and Greer to defend him. Atlantic

and the other two officers, Knickerbocker and Fisher, employed Crenshaw, Ware and Johnson to defend them.

After the court declined to certify the Gregory suit as a class action, members of the potential class filed some four additional actions similar to the Gregory suit. They were defended by the same counsel.

Among other things, the plaintiffs in the said actions sought to have the deeds of trust given by them to secure Atlantic for funds advanced for the costs of improvements to their homes declared null and void on the allegation that their signatures on such trusts had been obtained by trick, artifice, fraud and false pretenses. A compromise settlement was negotiated for the Gregory case and approved by all defendants including the Board of Directors of Atlantic. At the

same time the Board of Atlantic agreed that the officers and former officers named as defendants should be indemnified for all costs of defense and settlement. In the settlement the Gregory plaintiffs were to receive $115,000.00, plus their attorney's fees and costs in such sum as might be assessed by the court. Atlantic accordingly paid to the Gregory plaintiffs $115,000.00, to the Gregory plaintiffs' counsel $538,407.54 fees and costs; Williams, Worrell, Kelly & Greer for defense of Stephenson $303,001.25, and Crenshaw, Ware & Johnson for defense of Atlantic and its two officers, Knickerbocker and Fisher, in the Gregory suit $481,563.47.

The above facts are not in dispute.

A.

American in its defense asserted that Atlantic established a home improvement

loan program by which it would lend monies to home owners to make repairs and improvements to their homes; that in Atlantic's operation of the program it would have home improvement contractors contact homeowners and negotiate a contract with homeowner for the contractor to make certain improvements; and that in order to persuade the homeowner to contract for the work, the contractor would agree to obtain a loan from Atlantic. American asserted that Atlantic permitted the contractors to handle all of the paper work in connection with the loan; that some of the contractors were dishonest and misled, abused and mistreated the homeowner; that Atlantic sanctioned such conduct; and that when the homeowner could not repay the loan, the property was foreclosed. American asserts that as a result thereof, the suits of the homeowners followed. American further

asserted Atlantic was not entitled to recover in this action because (a) Atlantic withheld pertinent information in applying for the Policy and Bond; (b) that the expenses were not covered because Atlantic acted intentionally in allowing the dealers to act dishonestly in handling the loan transactions; (c) that even if there was coverage, only a small portion of the sums claimed would be due.

The Policy provided protection, including costs, expenses and attorney's fees to the officers and directors in accordance with its terms, including sums paid in settlement of claims. The Bond provided protection to Atlantic and Colonial.

American contended at trial that it was not liable under the Policy for any sums because in the application for renewal of the Policy Atlantic made a

material misrepresentation to the question of whether there had been during the prior policy period or was then, any suit pending against Atlantic or its subsidiaries. Secondly, American said that under the Policy it was not liable for any sums paid in settlement of any claim, costs, expenses or attorney's fees paid on behalf of Atlantic, but that if liable at all, its liability was limited to the sums paid on behalf of the three defendants who were officers or directors.

B.

The jury was charged that it was to determine whether a false answer had been made and whether the three officers who were defendants knew of the false answers, and what part of the sums, if any, paid in settlement and defending the action, were paid on behalf of Atlantic and what parts, if any, were paid on behalf of the three

individual defendants; that if the jury found the three individual defendants were covered by the Policy, and that they sustained a loss or losses within the coverage of the Policy, what portion of the sums sought for settlement, costs, expenses and attorney's fees were reasonably allocable to the claims against the three individual defendants as opposed to the claims against Atlantic. Further, the jury was charged that the Bond was to indemnify only Atlantic and Colonial for any losses sustained, or costs and attorney's fees incurred in defending against any claim within the coverage of the Bond; that if the jury found that Atlantic answered "No" to the question in the Bond application of "Was there any criticism of your operation at the most recent audit or examination, either federal or state" and that the answer was false when made, there

could be no recovery under the Bond. Further the jury was charged that the right of Atlantic to recover under the Bond was dependent upon whether covered by the Bond; that the Bond provided that American would indemnify Atlantic and Colonial against court costs and reasonable attorney's fees incurred and paid by Atlantic or Colonial in defending suits seeking to enforce liability against Atlantic and Colonial if covered by the Bond, and that Atlantic had the burden to prove it sustained a loss or losses covered by either the securities insuring agreement or by fraudulent mortgage rider of the Bond; that Atlantic must prove it suffered a loss due to its reliance in good faith and in the course of business on forged or altered agreements in writing having value transferable by delivery or that it relied in good faith and in the

course of business on real property deeds or deeds of trust which proved to have been obtained through trick, artifice, fraud or false pretenses.

On interrogatories submitted to the jury, without objection, it found:

> 1. Do you find that the defendant, American Casualty Company, has met its burden of clearly proving that the Renewal Proposal for the Directors and Officers Liability Insurance Policy contained a misrepresentation of fact that was knowingly false?
>
> ANSWER: "Yes" or "No" No
>
> 2. Whether all or any portion of the defense and settlement expenses sought in this lawsuit were incurred on behalf of Mr. Stephenson, Mr. Knickerbocker and Mr. Fisher as opposed to Atlantic Permanent and Colonial Service Corporation?
>
> $411,902.50 For Stephenson
>
> $535,634.39 For Knickerbocker and Fisher
>
> 3. Do you find that the defendant, American Casualty Company of Reading, Pennsylvania, has met its burden of clearly proving that the 1982

application for the Savings and Loan Blanket Bond contained a misrepresentation of fact that was knowingly false?

ANSWER: "Yes" or "No" No

4. Did Atlantic act in good faith and in the course of business in connection with the loans and deeds of trust obtained from the plaintiffs in the Gregory litigation?

ANSWER: "Yes" or "No" No

5. If you find that Atlantic is entitled to recover under the bond, what sum is it entitled to recover?

0	0
For attorneys fees, costs and expenses	For the part of the sums paid in settlement of the Gregory suit.

II.

Insurance contracts are prepared by the insurer and should be construed liberally in favor of the insured and strictly against the insurer. Where two constructions are equally possible, that most favorable to the insured must be adopted. St. Paul Fire & Marine Insurance

Co. v. S.L. Nusbaum & Co., 227 Va. 407, 316 S.E.2d 734 (1984); First American Title Insurance Co. v. Seaboard Savings & Loan Association, 227 Va. 379, 315 S.E.2d 842 (1984). See also Stroehmann v. Mutual Life Insurance Co., 300 U.S. 435, 57 S. Ct. 607 (1937); Aschenbrenner v. United States Fidelity and Guaranty Co., 292 U.S. 80, 54 S.Ct. 590 (1934); Jefferson-Pilot Fire & Casualty Company v. Boothe, Prichard & Dudley, 638 F.2d 670 (4th Cir. 1980).

Under Virginia law, which is applicable to this case, as well as the law generally, if an insurance carrier had the duty to defend its insured on any one of the allegations set forth in the pleadings, then the insurer has a duty to defend on all of the allegations. Reisen v. Aetna Life & Casualty Co., 225 Va. 327, 331, 302 S.E.2d 529 (1983); Norman v.

Insurance Co. of North America, 218 Va. 718, 725, 239 S.E.2d 902 (1978); Baker v. American Insurance Company of Newark, 324 F.2d 748, 750 (4th Cir. 1963); Jefferson-Pilot Fire & Casualty Co. v. Boothe, Pricthard & Dudley, supra.

The Virginia Supreme Court in Parker v. Hartford Fire Insurance Co., 278 S.E.2d 803, 804 (1981) (per curiam) held:

> when an initial pleading alleges facts and circumstances, some of which would, if proved, fall within the risk covered by the policy, the insurance company is obligated to defend its insured.

Parker, supra at 804, quoting Lerner v. Safeco, 219 Va. 101, 104, 245 S.E.2d 249, 251 (1978). Only where it appears that the insurer "would not be liable under its contract for any judgment based upon the allegations does the company have no duty to defend." Parker, supra at 804. (emphasis retained). See also Travelers v. Obenshain, 219 Va. 44, 46, 245 S.E.2d

247, 249 (1978). Consequently, if any one of the allegations made in the Gregory suit, or the other actions, fall within the scope of the coverage, then the insurer is obligated to defend the defendants on all the allegations of that suit. Conversely, if the insurer is not liable for any of the allegations made, then it has no duty to defend the defendants. Reisen, supra, at 531.

An insured's duty to defend an action in accordance with the terms of the policy must be ascertained from the face of the complaint. The "duty to defend. . .arises whenever the complaint alleges facts, some of which would, if proven, fall within the risk covered by the policy." Jefferson-Pilot Fire, supra at 674, applying Virginia law. See also Lerner v. Safeco, supra; Donnelly v. Transportation Ins. Co., 589

F.2d 761 (4th Cir. 1978); Baker v. American Insurance Co., supra.

Policy extensions are construed most strongly against the insurer, Lincoln National Life Insurance Co. v. Commonwealth Corrugated Container Corp., 229 Va. 132, 137, 327 S.E.2d 98 (1985), and any language attempting to limit the liability of the insurer is to be construed strongly against the insurance company. Ayers v. Harleyville Casualty Co., 172 Va. 383, 389, 2 S.E.2d 303 (1939). See also Gill v. Rollins Protective Services Co., 722 F.2d 55, 58 (4th Cir. 1983). "Without difficulty respondent could have expressed in plain words the exception for which it now contends." Stroehmann, supra, 300 U.S. at 440, 57 S.Ct. at 609.

Though the policy issued is one of indemnity, and not one of defense, the policy is to indemnify the insured against

costs, damages, and attorneys' fees incurred, and is governed by the same principles of law.

The Policy issued in this case, among other things, provides:

> 1. Definitions
>
> (d) The term "Loss" shall mean any amount which the Directors and Officers are legally obligated to pay or for which the Association is required to indemnify the Directors or Officers, or for which the Association has to the extent permitted by law indemnified the Directors and Officers for a claim or claims made against the Directors and Officers for Wrongful Acts and shall include but not be limited to damages, judgments, settlements, costs (exclusive of salaries of officers or employees) and defense of legal actions, claims or proceedings and appeals therefrom, and cost of attachment or similar bonds, provided however, such loss shall not include fines or penalties imposed by law or matters which may be deemed uninsurable under the law pursuant to which this policy shall be construed.
>
> (e) The terms "Wrongful Act" shall mean any actual or alleged error, misstatement, misleading

statement, act or omission, or neglect or breach of duty by the Directors or Officers in the discharge of their duties solely in their capacity as Directors or Officers of the Association, individually or collectively, or any matter claimed against them solely by reason of their being Directors or Officers of the Association.

3. Exclusions

(a) Except for loss for which the Association is required to indemnify the Directors or Officers, or for which the Association has, to the extent permitted by law, indemnified the Directors or Officers, the Insurer shall not be liable to make any payment for loss in connection with any claim made against the Directors or Officers.

. . . .

(5) brought about or contributed to by the dishonesty of the Directors or Officers. However, notwithstanding the foregoing, the Directors or Officers shall be protected under the terms of this policy as to any claims upon which suit may be brought against them, by reason of any alleged dishonesty on the part of the Directors or Officers, unless a judgment or other final adjudication thereof adverse to the Directors or Officers shall establish that acts of active and deliberate dishonesty

committed by the Directors or Officers with actual dishonest purpose and intent were material to the cause of action so adjudicated.

NOTE: The Wrongful Act of any Director or Officer shall not be imputed to any other Directors or Officers for the purpose of determining the applicability of the exclusions enumerated in this Clause 3.

4. Limits of Liability

(a) The Insurer shall be liable to pay one hundred percent (100%) of any Loss (including costs, charges and expenses as referred to in Clause 5) in excess of the retention amount shown under Item 4 of the Declarations up to the Limit of Liability stated in Clause 4(b) and 4(c) below. One retention amount shall apply to each and every Loss.

III.

American complains of the action of the court in sustaining Atlantic's objections to witness Wendt testifying as an expert.

American now asserts that Wendt was prepared to testify that had Atlantic not

omitted from its renewal application the reference to five lawsuits allegedly pending against it, that is, misrepresented the facts, American would not have included coverage for the home improvement program in the Policy. Whether he would or would not have issued the Policy in question because of any such alleged misrepresentation is now moot. The jury found there was no such misrepresentation. The proffered testimony went only to the materiality of the alleged misrepresentation and not to whether there was any misrepresentation. The fact is, the uncontradicted evidence on this question clearly establishes there was no misrepresentation.

But, even if the testimony was relevant, American had not complied with the rules of court to enable it to offer such testimony. Plaintiff was never

notified or advised in any manner that Wendt would be called to testify as an expert and requested to state an opinion. He was not so named or listed when American was requested to advise the names of experts or what expert evidence he would give. Nor was he listed in the final pretrial order as an expert witness. The court refused to permit him to express an opinion as an expert

The court has an extensive procedure for discovery and pretrial. Even prior to the adoption of Rule 16 of the Federal Rules of Civil Procedure, this court had such a procedure. Time for cutoff of discovery, listing of witnesses, with their designations, were provided for. Atlantic objected to the witness testifying as an expert because he had not previously been named as an expert, and was not so listed in the pretrial order as

required by the rules of the court. Not having been previously named as an expert, Atlantic had not had an opportunity to take his discovery. The court refused to permit him to testify as an expert expressing opinions and inferences "both because he had not been listed in any of the pretrial orders, and more importantly, had not been identified to plaintiff's counsel" as an expert prior to his testifying. Adalman v. Baker, Watts & Co., No. 85-1964(L) (4th Cir., October 31, 1986).

The fact is, that even if the denial of the right to so testify was error, it was harmless, for another witness of American testified concerning the same matter and Wendt's testimony was merely cumulative.

IV.

American's interpretation of many of the clauses and provisions of the Policy are indeed strained. It attempts to completely change the language and meaning of the words it used in writing the policy. It attempts to change the meaning of "Wrongful Act" to that of an "intentional act." It seeks to escape liability with the assertion that acts committed were within "uninsurable acts" under Virginia law. It says that such acts are not those based on dishonesty which fall within the inclusion of the Policy, but based on public policy which are not insurable. This issue has been dealt with in an opinion previously filed by Judge Clarke of this court and need not be repeated here. In any event, there is no

evidence to establish that any act falls within the "intentional acts" dealt with under public policy of Virginia.

V.

As stated above, defendant has moved the court to amend the verdict of the jury to provide for the deductible provisions of the Policy. The parties, at time of trial, and now, are in accord with the fact the verdict must be amended to reduce the amount of the verdict by the sum deductible in accord with the Policy.

The Policy provides under item 4:

> Retention (each loss)
> $10,000.00

The definition of "Loss" and applicable "Exclusions," as well as "Limits of Liability," are set out above and need not be repeated here.

Defendants assert that because each of the nine Gregory plaintiffs (counting co-borrowers as one) asserted seven

separate claims against the individual defendants there were 63 deductible amounts, or $630,000.00. In oral argument defendant only urged that $90,000.00, based on the number of different transactions and properties at issue, was the correct sum to be deducted. That is, $10,000.00 for each of nine claims.

Plaintiff asserts that the total deduction should be $10,000.00.

The word "Loss" is capitalized throughout the definitions, and, as shown above, means any amount which the Directors and Officers are legally obligated to pay or for which the Association has, to the extent permitted by law, indemnified the Directors and Officers, "for a claim or claims" made against the Directors and Officers for "Wrongful Acts." (Par. 1(d) of Policy set out above). That is, claims for "Wrongful Acts" whether by reason of

damages, judgments, settlements or costs. Id. Too, as shown above, claims based on or arising out of the "same act, interrelated acts, or one or more series of similar acts" of one or more of the Directors or Officers "shall be considered a single loss." (Par. 4(d) of the Policy set out above).

The complaint and the amended complaint in the Gregory case allege a series of similar and interrelated acts growing out of the same wrongful acts of the officers.

The "Loss" in this case was the sum of $115,000.00 paid in settlement of the single underlying action, the Gregory case. The action was instituted by nine plaintiffs (husband and wife counted as one) grounded in the alleged same cause of action for all the plaintiffs. The complaint alleges that, among other

things, the defendants therein conspired, agreed and collaborated on a scheme to injure them and joined in with the contractors, they devised, promulgated and put into effect and action, a "home improvement loan program"; that in the establishment, promotion and carrying out of said home improvement program, certain acts and things were done, to the injury of the borrowers. The home improvement program was alleged as the cause of the injury. It is abundantly clear all of the complained of acts, wrongs, things, damages and claims arose out of the one and same cause, the "home improvement program"; that the formation, planning, implementing and promotion of the said "home improvement program" was [sic] the bases of the alleged losses and complaints; that there was one proximate, uninterrupted and continuing course of

action which resulted in all of the said losses; that the "home improvement program" was an ongoing and continuing program plan and event, which included the program of foreclosure. The fact is, plaintiff there sought to have the action declared a "class action." The cause of the loss was the establishment of the "home improvement program" which was an uninterrupted and continuing cause resulting in all of the injuries and damages. American set forth in detail in its brief filed herein in support of its motion for judgment n.o.v., under Exhibit "A" that Atlantic established a "home improvement department, [sic] "and selected a particular individual as its head"; that as a result of the manner in which the operation of this department was carried on, the losses arose. In fact, Colonial, through which the home improvement was

conducted was made a party defendant. American, in characterizing the Gregory suit allegations, said Atlantic, its subsidiary, Colonial Service Corporation, and Stephenson, had acted improperly in connection with the loans.

Defendant relies upon North River Insurance Company v. Huff, 628 F. Supp. 1129, (D.C. Kan. 1985) to support its contention. The policy language in North River is quite different from the Policy here. North River cited Appalachian Insurance Company v. Liberty Mutual Insurance Company, 676 F.2d 56 (3d Cir. 1982) and Business Interiors, Inc. v. The Aetna Casualty and Surety Company, 751 F.2d 361 (10th Cir. 1984), neither of which seem to support defendants' argument here. Business Interiors held that "an occurrence is determined by the cause or causes of the resulting injury." 751 F.2d

at 362. It cites Appalachian Insurance, supra, for such a holding. Further, in Business Interiors the court found that the acts of a dishonest employee who forged or materially altered forty checks constituted a single loss under the insurance policy. The court there reasoned that the probable intent of the employee was to continue the dishonesty, as opposed to committing new acts of dishonesty. The cause theory as set out in Appalachian Insurance is whether there was but one proximate, uninterrupted, and continuing cause, which resulted in all of the injuries and damage. The Appalachian Insurance case held there was but one occurrence, even though there were "multiple injuries and that they were of different magnitudes and that injuries extended over a period of time." 676 F.2d at 61.

In North River, one policy declared the limit of liability in terms of a "per incident" basis, and the other "per occurrence."

Pursuant to the provisions of the Policy, the judgment heretofore entered in this case against American should be credited with and reduced by the sum of $10,000.00. The clerk will therefore enter such amended judgment. The motion n.o.v., or in the alternative for a new trial, is therefore DENIED.

Copy of this opinion and order is forwarded to counsel.

_____

United States District Judge

Norfolk, Virginia

March 12th, 1987

APPENDIX D

IN THE UNITED STATE DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Norfolk Division

ATLANTIC PERMANENT FEDERAL
SAVINGS & LOAN ASSOCIATION,
Plaintiff,
v. Civil Action No.
86-172-N
AMERICAN CASUALTY COMPANY
OF READING, PENNSYLVANIA,
Defendant.

FORM OF SPECIAL VERDICT
PURSUANT TO FED.R.CIV.P. 49(a)

1. Do you find that the defendant, American Casualty Company, has met its burden of clearly proving that the Renewal Proposal for the Directors and Officers Liability Insurance Policy contained a misrepresentation of fact that was knowingly false?

ANSWER: "Yes" or "No" No

2. If your answer to the preceding question was "No" do not answer this question. If your answer to the foregoing question is "Yes", was any such

misrepresentation material to the decision of American Casualty Company to write the policy?

ANSWER: "Yes" or "No" ____

3. Whether all or any portion of the defense and settlement expenses sought in this lawsuit were incurred on behalf of Mr. Stephenson, Mr. Knickerbocker and Mr. Fisher as opposed to Atlantic Permanent and Colonial Service Corporation?

$411,902.50	$535,634.39
For Stephenson	For Knickerbocker and Fisher

4. Do your find that the defendant, American Casualty Company of Reading, Pennsylvania, has met its burden of clearly proving that the 1982 application for the Savings and Loan Blanket Bond contained a misrepresentation of fact that was knowingly false?

ANSWER: "Yes" or "No" No

5. If your answer to the preceding question is "No" do not answer this question, If your answer to the preceding question is "Yes", was any such misrepresentation material to the decision of American Casualty Company to write the policy?

ANSWER: "Yes" or "No" ____

6. Did Atlantic act in good faith and in the course of business in connection with the loans and deeds of trust obtained from the plaintiffs in the Gregory litigation?

ANSWER: "Yes" or "No" No

7. If you find that Atlantic is entitled to recover under the bond, what sum is it entitled to recover?

-0-	-0-
For Attorneys Fees, Costs and Expenses	For the part of the sums paid in settlement of the Gregory suit

DATED:_____ _____
FOREMAN

APPENDIX E

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF VIRGINIA
Norfolk Division

ATLANTIC PERMANENT FEDERAL
SAVINGS AND LOAN ASSOCIATION

v. JUDGMENT IN A CIVIL CASE

AMERICAN CASUALTY COMPANY
OF READING, PENNSYLVANIA

Case Number: 86-172-N

/ / **Jury Verdict.** This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

/x/ **Decision by Court.** This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the defendant's motion to set aside the verdict of the jury and enter judgment for the defendant notwithstanding the verdict, or grant the defendant a new trial is denied.

It is further ORDERED AND ADJUDGED that the judgment heretofore entered on the jury verdict against the defendant is amended as follows: plaintiff is granted judgment of the defendant in the sum of Nine Hundred Thirty-seven Thousand, Five Hundred Thirty-six and 89/100 Dollars ($937,536.89), with interest thereon at the rate of 5.75 per cent as provided by law, and its costs of action.

March 12, 1987
Date

Doris R. Casey, Clerk
Clerk

_____
(By) Deputy Clerk

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 87-1572

Atlantic Permanent Federal
Savings and Loan Association,
Plaintiff - Appellee,

v.

American Casualty Company of
Reading, Pennsylvania,
Defendant - Appellant.

On Petition for Rehearing

Upon consideration of the appellant's petition for rehearing,

IT IS ORDERED that the petition for rehearing is denied.

Entered at the direction of Judge Phillips, with the concurrence of Judge

Russell and Senior Judge Haynsworth.

For the Court

_____

CLERK

APPENDIX G

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 87-1572

Atlantic Permanent Federal
Savings and Loan Association,
Plaintiff - Appellee,

v.

American Casualty Company of
Reading, Pennsylvania,
Defendant - Appellant.

Appeal from the United States District Court for the Eastern District of Virginia, at Norfolk. Richard B. Kellam, Senior District Court Judge

---

Upon consideration of appellant's motion to recall and stay the mandate, appellee's response to the motion, and appellant's reply in support of the motion,

IT IS ORDERED that the motion is granted and the mandate of this Court is

hereby recalled and stayed for a period of 30 days in order to permit the appellant to apply to the United States Supreme Court for writ of certiorari.

Entered at the direction of Judge Russell with the concurrence of Judge Phillips and Judge Haynsworth.

For the Court,

_____

CLERK

APPENDIX H

STATUTES AND REGULATIONS INVOLVED
12 C.F.R. § 545.121 (1984)

§ 545.121 Indemnification of directors, officers and employees.

A Federal association shall indemnify its directors, officers, and employees in accordance with the following requirements:

(a) Definitions and rules of construction. (1) Definitions for purpose of this section.

(i) Action. Any judicial or administrative proceeding, or threatened proceeding, whether civil, criminal, or otherwise, including any appeal or other proceeding for review;

(ii) Court. Includes, without limitation, any court to which or in which any appeal or any proceeding for review is brought.

(iii) Final judgment. A judgment, decree, or order which is not appealable or as to which the period for appeal has expired with no appeal taken.

(iv) Settlement. Includes entry of a judgment by consent or confession or a plea of guilty or nolo contendere.

(2) References in this section to any individual or other person, including any association, shall include legal representatives, successors, and assigns thereof.

(b) General. Subject to paragraph (c) of this section, an association shall indemnify any person against whom an action is brought or threatened because that person is or was a director, officer, or employee of the association, for:

(1) Any amount for which that person becomes liable under a judgment in such action; and

(2) Reasonable costs and expenses, including reasonable attorney's fees, actually paid or incurred by that person in defending or settling such action, or in enforcing his rights under this section if he attains a favorable judgment in such enforcement action.

(c) Requirements. Indemnification shall be made to such person under paragraph (b) of this section only if:

(1) Final judgment on the merits is in his favor; or

(2) In case of: (i) Settlement (ii) final judgment against him, or (iii) final judgment in his favor, other than on the merits, if a majority of the disinterested directors of the association determine that he was acting in good faith within the scope of his employment or authority as he could reasonably have perceived it under the circumstances and for a purpose he could reasonably have believed under the circumstances was in the best interests of the association or its members. However, no indemnification shall be made unless the association gives the Board at least 60 days' notice of its intention to make such indemnification. Such notice shall state the facts on which the action arose, the terms of any settlement, and any disposition of the action by a court. Such notice, a copy thereof, and a certified copy of the resolution containing the required determination by the Board of directors shall be sent to the Supervisory Agent, who shall promptly acknowledge receipt thereof. The notice period shall run from the date of such receipt. No such indemnification shall be made if the Board advises the association in writing, within such notice period, of its objection thereto.

(d) Insurance. An association may obtain insurance to protect it and its directors, officers, and employees from potential losses arising from claims against any of them for alleged wrongful acts, or wrongful acts, committed in their capacity as directors, officers, or employees. However, no association may obtain insurance which provides for payment of losses of any person incurred as a consequence of his willful or criminal misconduct.

(e) Payment of expenses. If a majority of the directors of an association concludes that, in connection with an action, any person ultimately may become entitled to indemnification under this section, the directors may authorize payment of reasonable costs and expenses, including reasonable attorney's fees, arising from the defense or settlement of such action. Nothing in this paragraph shall prevent the directors of an association from imposing such conditions on a payment of expenses as they deem warranted and in the interests of the association. Before making advance payment of expenses under this paragraph, the association shall obtain an agreement that the association will be repaid if the person on whose behalf payment is made is later determined not to be

entitled to such indemnification.

(f) Exclusiveness of provisions. No association shall indemnify any person referred to in paragraph (b) of this section or obtain insurance referred to in paragraph (d) of this section other than in accordance with this section. However, an association which has a bylaw in effect relating to indemnification of its personnel shall be governed solely by that bylaw, except that its authority to obtain insurance shall be governed by paragraph (d) of this section.

[48 FR 23058, May 23, 1983, as amended at 49 FR 43045, Oct. 26, 1984]

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NO. 87-1775

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

AMERICAN CASUALTY COMPANY OF READING PENNSYLVANIA,

Petitioner,

v.

ATLANTIC PERMANENT FEDERAL SAVINGS & LOAN ASSOCIATION,

Respondent.

BRIEF IN OPPOSITION TO A PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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No. 87-1775

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1987

AMERICAN CASUALTY COMPANY OF
READING, PENNSYLVANIA,
Petitioner,

v.

ATLANTIC PERMANENT FEDERAL [1]
SAVINGS & LOAN ASSOCIATION,
Respondent.

BRIEF IN OPPOSITION TO A PETITION FOR
WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

---

[1]. Pursuant to Rule 28.1 Respondent states that it has no parent company and no subsidiaries other than wholly owned subsidiaries.

REASONS FOR DENYING THE WRIT

1. There Is No Issue Subject To Review Under Rule 17.

This case involves nothing more than the application of principles of State law to the interpretation of an insurance policy. Based upon rules of construction enunciated by the Supreme Court of Virginia, the Court of Appeals for the Fourth Circuit affirmed the trial court's decision that the insured savings and loan association was entitled to proceed as subrogee to its officers under Clause A of its Directors' and Officers' Liability Policy. In a footnote to its opinion, the Court of Appeals suggested that the Association was not entitled to recover under Clause B of its policy because it had failed to observe certain procedural requirements of the Federal

Home Loan Bank Board. It is upon this footnote that the Petitioner bases its petition for a writ of certiorari.

The decision of the Court of Appeals is not in conflict with a decision of any other circuit or with any decision of the Supreme Court of Virginia, and it does not pose a conflict with any decision of this Court or decide any unsettled question of Federal law which should be resolved by this Court.

2. The Directors' and Officers' Liability Policy and Federal Regulations.

The Directors' and Officers' Liability Policy contains two insuring clauses. Clause A provides coverage to the Association's officers and directors and Clause B provides direct coverage to the Association. Anyone seeking to recover under Clause A is subject to

certain significant exclusions which are not applicable to anyone seeking to recover under Clause B. Thus, the route to recovery can be more difficult under Clause A.

Neither Clause A nor B makes any reference to Federal regulations. Any such reference is inferential by reason of the language of Clause B which provides that an association may recover directly for "all Loss for which the Association has, to the extent permitted by law, indemnified the Directors and Officers." The phrase "as permitted by law" is presumed to refer to the procedures for indemnification specified by the Federal Home Loan Bank Board (FHLBB).

An association seeking to recover as a subrogee under Clause A would be faced

with the policy exclusions, whereas an association seeking to recover as a direct insured under Clause B would be subject to the provision that its indemnification procedures be "as permitted by law." Here, the Association alleged a right to recover under both Clauses A and B.

In interpreting the policy, both the trial court and the appellate court found nothing to prohibit an association from seeking a recovery as subrogee under Clause A. The Court of Appeals simply reasoned that under State law any ambiguities were to be resolved favorably to the insured and that if the insurer, which drafted and marketed the policy, had intended to restrict an association's right to recover as subrogee under Clause A, it need only have redrafted the

language of its policy. (Pet. App. 16a-17a).

The insured was entitled to rely upon the language of the policy as it was written. It is reasonable to assume that if American Casualty had written its policy differently so also might Atlantic Permanent have effected its officers' indemnification differently.

The regulations upon which the Petitioner relies were promulgated pursuant to the Home Owners' Loan Act of 1933, 12 U.S.C. §1461 et seq. The enforcement of the Act and any regulations issued under the Act was entrusted to the FHLBB. 12 U.S.C. §1464(d)(1).

The specific regulations to which the Petitioner has made reference appear at 12 C.F.R. §545.121. These regulations

require such things as 60 days notice to the FHLBB prior to indemnification and an agreement with the officer seeking assistance that he will make restitution if later found not to be entitled to indemnification. The procedures for indemnification employed by Atlantic Permanent, although not consistent with the letter of the regulations, were expressly sanctioned by the FHLBB, as evidenced by letter of September 29, 1986 from Supervisory Agent, Robert J. Cohrs, to the Chairman of Atlantic's Board. (Res. App. 1a).

These regulations obviously were not written for the benefit of the insurance industry and the FHLBB was entitled to waive its indemnification procedures to whatever extent it chose to do so. The regulations were for the benefit of the

public in general and, more specifically, for the benefit of the stockholders and depositors of the affected Federal associations.

Given the language of the Policy and the nature and purpose of the FHLBB regulations, it is difficult to conceive of any preemptive provision which would alter the coverage available to an insured under State law.

3. The Preemption Provision of the FHLBB Regulations

The preemption provision upon which Petitioner relies is relatively narrow.

> The regulations in this Part 545 are promulgated pursuant to the plenary and exclusive authority of the Board to regulate all aspects of the operations of Federal associations, as set forth in section 5(a) of the Home Owners' Loan Act of 1933. 12 U.S.C. 1464, as amended. This

> exercise of the Board's authority is preemptive of any state law purporting to address the subject of the operations of a Federal association.

12 C.F. R. §545.2. The FHLBB preemption is designed to avoid a conflict with state statutes expressly undertaking to regulate Federal associations. There is nothing in the language of the regulations which would suggest that it was intended, in any context, to abrogate the common law of the State in which an association does business. On the contrary, the words of the regulation, "purporting to address the subject of the operations of a Federal association," clearly indicate that State law is preempted only to the extent that it attempts to govern the operations of a Federal association.

The limited purpose of this particular preemptive provision is evident when compared with the more expansive preemptive provisions in other areas of Federal regulation, i.e. the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. §1001 et seq.

> Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan. (Emphasis added)

29 U.S.C. §1144(a).

Seeking grounds for a writ under Rule 17, Petitioner suggests that the decision of the Court of Appeals will result in a conflict among the Circuits. In support of its position, Petitioner

cites three cases,[2] each of which involved a wrongful death action based upon an alleged failure of a cigarette manufacturer to give adequate warning of the dangers of smoking. In each instance the defense raised the preemptive provisions of the Federal Cigarette Labeling and Advertising Act ("FCLAA"), 15 U.S.C. §§1331-1341. There, the preemption is statutory, not regulatory, and it is both specific and comprehensive.

> (a) No statement relating to smoking and health, other than the statement required by section 1333 of this title, shall be required on any cigarette package.

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[2] Palmer v. Liggett Group, Inc., 825 F.2d 260 (1st Cir. 1987); Stephen v. American Brands, Inc., 825 F.2d 312 (11th Cir. 1987); Cipollone v. Liggett Group, Inc., 789 F.2d 181 (3d Cir. 1986), cert. denied 107 S.Ct. 907 (1987).

> (b) No requirement or prohibition based on smoking and health shall be imposed under State law with respect to the advertising or promotion of any cigarettes the packages of which are labeled in conformity with the provisions of this chapter.

15 U.S.C. §1334. The Congressional declaration of policy and purpose in passing the Act is also specific, and it deals directly with the issues involved in the cited cases.

> It is the policy of the Congress, and the purpose of this chapter, to establish a comprehensive Federal program to deal with cigarette labeling and advertising with respect to any relationship between smoking and health, whereby--
>
> > (1) the public may be adequately informed about any adverse health effects of cigarette smoking by inclusion of warning notices on each package of cigarettes and in each advertisement of cigarettes; and

> (2) commerce and the national economy may be (A) protected to the maximum extent consistent with this declared policy and (B) not impeded by diverse, nonuniform, and confusing cigarette labeling and advertising regulations with respect to any relationship between smoking and health.

15 U.S.C. §1331. These provisions afford no reasonable basis for analogy to this case. Here, the preemptive provisions are regulatory; they do not go to the substance of the dispute between the parties and they are limited in scope to "state law purporting to address the subject of the operations of a Federal association." 12 C.F.R. §545.2

Under the canons of construction, a basic assumption must be made that there was no intention to displace State law. Maryland v. Louisiana, 451 U.S. 725, 746 (1981). This is particularly true when the claim of preemption is based upon

Federal regulations; agencies generally address a topic in far greater detail than Congress. Hillsborough County v. Automated Med. Labs., 471 U.S. 707, 718 (1985).

Even in cases involving statutory preemptive provisions, the Courts have declined to preempt State law in absence of explicit preemptive provisions. Ferebee v. Chevron Chemical Co., 736 F.2d 1529 (D.C. Cir. 1984), cert. denied 469 U.S. 1062 (1984). In Ferebee, the Court of Appeals for the District of Columbia held that the preemptive provisions of the Federal Insecticide, Fungicide, and Rodenticide Act, 7 U.S.C. §136 et seq., did not preclude an action under State law for wrongful death resulting from an alleged inadequate warning label, despite EPA approval of the label and the fact

that the Act provided that a state "shall not impose or continue in effect any requirements for labeling...in addition to or different from those required under this subchapter." 7 U.S.C. §136V(b). "First, Congress has not explicitly preempted state damage actions; it has merely precluded states from directly ordering changes in the EPA-approved labels." Ferebee, supra at 1542.

A succinct statement of this Court's position on preemption by Federal regulation appears in Florida Avocado Growers v. Paul, 373 U.S. 132, 142, reh'g denied 374 U.S. 858 (1963):

> The principle to be derived from our decisions is that federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons - either that the nature of the regulated subject matter permits no other conclusion, or

> that the Congress has unmistakably so ordained.

There is nothing in the FHLBB regulations which deals with State subrogation laws or the rules of construction of a liability policy. These are the issues upon which this case was decided. Petitioner has cited no decision of this Court or of any Circuit Court which, in any remotely similar context, has found preemption by Federal regulations.

Summary of Argument

The decision of the Court of Appeals for the Fourth Circuit was based upon the doctrine of subrogation and the rules of construction applicable under the laws of the Commonwealth of Virginia. Neither logic nor precedent supports Petitioner's argument that State subrogation law is abrogated by a preemptive provision

which speaks only of State laws directed to the regulation of a Federal association. Indeed, the argument is specious. Had the Petitioner intended that an insured association have no right to subrogation, it need only have inserted an appropriate provision in its policy.

Petitioner has demonstrated no conflict among the Circuits and there is no ground for a writ of certiorari under Rule 17.

Conclusion

The Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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Dated May 16, 1988

APPENDIX

FEDERAL HOME LOAN BANK BOARD
Peachtree Center Station
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260 Peachtree Street, N.W.
Atlanta, Georgia 30343
404/522-2450

Office of
Supervisory Agent

September 29,1986

FHLLBB No. 1179

Mr. Edgar S. Everhart
Chairman of the Board
Atlantic Permanent Federal Savings
and Loan Association
740 Boush Street
Norfolk, Virginia 23510

Dear Mr. Everhart:

I am writing this letter to confirm that Atlantic Permanent Federal Savings and Loan Association sent me a copy of the

resolution of its board of Directors adopted July 15, 1985, approving the settlement of the lawsuit styled Gregory, et al v. Atlantic Permanent, et al and authorizing the indemnification of current officers and former officers of the association for their cost of defense and settlement and that the Federal Home Loan Bank Board did not raise any objection to that indemnification under Section 545.121 of Subchapter C, Chapter V, Title 12, Code of Federal Regulations, and does not intend to raise any such objection.

Sincerely,

Robert J. Cohrs
Supervisory Agent

Supreme Court, U.S.
FILED
JUN 3 1988
JOSEPH F. SPANIOL, JR.
CLERK

NO. 87-1775

IN THE

Supreme Court of the United States

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AMERICAN CASUALTY COMPANY OF READING, PENNSYLVANIA,

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v.

ATLANTIC PERMANENT FEDERAL SAVINGS & LOAN ASSOCIATION,

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REPLY TO BRIEF IN OPPOSITION TO A PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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12 C.F.R. { 545.121.	1, 3, 6
12 C.F.R. { 563.43(d).	3

ARGUMENT

I. INTRODUCTION

This reply brief addresses several arguments raised in respondent's brief in opposition but not addressed in the petition.[1]

II. THE FHLBB LETTER IS IRRELEVANT

Respondent admits that it did not comply with the requirements of 12 C.F.R. § 545.121 when it indemnified its directors and officers for expenses relating to the underlying litigation. Brief in Opp., p. 7. However, respondent argues that its unlawful action was "sanctioned" by the Federal Home Loan Bank Board ("FHLBB") and that this alleged sanctioning brought

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[1] Pursuant to Rule 28.1 petitioner listed all of its parent corporations, subsidiaries (except wholly owned subsidiaries) and affiliates in its Petition for Writ of Certiorari.

respondent's action into compliance with the requirements of the directors' and officers' liability policy ("the Policy"). Id., pp. 7-8. This argument is based on an after-the-fact letter from an FHLBB Supervisory Agent. Brief in Opp., Appendix, p. 1-2.

Respondent's argument mischaracterizes the FHLBB letter and misapprehends the language of the Policy and the decision of the Court of Appeals. The letter in no way sanctions respondent's regulatory violations.[2] The FHLBB's letter merely acknowledges receipt of respondent's belated indemnification resolution and states that the FHLBB has not and will not "raise any objection to that

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[2] The Court of Appeals' opinion reviews respondent's failure to comply the FHLBB's indemnification regulations. Petition, Appendix pp. 14a-15a, fn.5.

indemnification under Section 545.121. . . ." Brief in Opp., Appendix at p. 2. The letter does not state that respondent's indemnification complied with FHLBB procedure. Nor did the letter say that the regulatory requirements did not apply to respondent due to regulatory waiver or any other reason. Indeed, respondent never asked the FHLBB to waive its indemnification procedures.[3]

The FHLBB letter constitutes no more or less than an announcement that the FHLBB did not intend to commence a regulatory proceeding to enforce the

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[3] 12 C.F.R. § 545.121 does not contain a waiver provision. To the contrary, the indemnification portion of § 545.121 makes it clear that there is only one permissible way for federal savings and loans to indemnify their directors and officers. By contrast, other portions of the FHLBB regulatory scheme do include waiver provisions. See e.g. 12 C.F.R. § 563.43(d).

indemnification regulations. The letter did not and could not change the law regarding the indemnification by federal savings and loans of their directors and officers.

Respondent's "regulatory sanction" argument concludes by asserting that the regulations were not written for the benefit of insurers. This apparent truth is irrelevant though, where an insurer has adopted a regulatory requirement as a prerequisite to recovery under its policy. This is the case here. American Casualty's policy expressly limits recovery by respondent to those losses "for which [it] is required to indemnify or for which [it] has, to the extent permitted by law indemnified the Directors and Officers." Petition, Appendix at p. 15a (emphasis supplied by Court of Appeals for the Fourth Circuit). The FHLBB's letter to

respondent altered neither the boundaries of the law relating to indemnification by respondent of its directors and officers nor the contractual prerequisite for recovering under the Policy. Respondent was not permitted by law to indemnify its directors and officers as it did. Since the policy adopts the regulatory standard, respondent is not entitled to recovery under the policy.

III. **THE PREEMPTION ISSUE**

Respondent's final argument focuses on the real issue in this case: federal preemption. Respondent argues that the preemption provision in 12 C.F.R. § 545.2 is "relatively narrow" and preempts only conflicting "state statutes expressly undertaking to regulate Federal associations." Brief in Opp., pp. 8-9. In so arguing respondent focuses on the phrase "purporting to address" in 12 C.F.R.

§ 545.2 and ignores the phrase "all aspects of the operations of Federal associations" in the prior sentence of the section. Read together, the two sentences of the preemption provision indicate the breadth of the FHLBB's regulatory scheme and refutes the argument that only state statutory law is affected by the regulations.

Respondent's argument also ignores 12 C.F.R. § 545.121(c) and (f) which unequivocally state that the indemnification regulations set forth the only way by which federal associations may indemnify directors and officers. Thus, contrary to respondent's assertion (Brief in Opp., p. 13) the FHLBB regulations directly address the very substance of the dispute between

the parties.[4] These provisions leave no doubt as to the FHLBB's intent to preempt all conflicting state law, including application of the principle of subrogation as a method of circumventing the regulatory requirements for indemnifying directors and officers.

Citing Maryland v. Louisiana, 451 U.S. 725 (1981), respondent relies on the presumption against displacement of state law by federal law. Brief in Opp., p. 13. However, as this Court pointed out in Maryland v. Louisiana, this presumption may be overcome even without an express preemption provision. Id. at 746. Where,

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[4] Ferebee v. Chevron Chemical Co., 736 F.2d 1529 (D.C. Cir.), cert. denied, 469 U.S. 1062 (1984), does not support respondent's argument because the preemption provision at issue there was expressly limited to labeling requirements and the state laws at issue related to wrongful death actions.

as here, the pertinent regulations expressly provide for preemption of state law, the presumption is irrelevant.

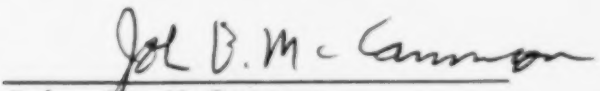
The FHLBB has provided specific procedures for the indemnification of association officers and directors; these procedures may not be circumvented through reliance on a contrary principle of state common law for the convenience of a party which has failed to comply with explicit regulatory requirements.

CONCLUSION

For the reasons stated in the petition and in this reply brief, petitioner

asks that the requested writ be granted.

Respectfully submitted,



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Dated June 2d, 1988

APPENDIX

12 C.F.R. § 563.43(d)

> **Waiver.** The restrictions in paragraph (b) and (c) of this section may be waived by the Board in supervisory cases if the Board determines that the terms of the transaction in question are fair to, and in the best interests of, the insured institution or subsidiary. A supervisory case includes a merger instituted for supervisory reasons, and action taken pursuant to, or in order to obviate the necessity of, proceedings by the Board or the Corporation pursuant to paragraph (d) of section 5 of the Home Owners' Loan Act of 1933, as amended (12 U.S.C. 1464(d)), or section 407 of the National Housing Act, as amended (12 U.S.C. 1730).